NNDR Consultation Response

We at Localis have long been active in arguing for a new system of National Non-Domestic Rates, and are delighted to be feeding into this consultation. A reformed NNDR, we believe, can form a vital cog in any growth strategy for the coming years – driving improved economic performance from the bottom up. In March this year we published a report – *The Rate Escape: Freeing Local Government to Drive Economic Growth* – which argued for a more localised business rates system, and proposed a model for how this system could work.

The principles that underpinned our research, a description of how our model would work, and the report's recommendations are reproduced below. The full report can be downloaded from our website www.localis.org.uk

Principles for reform

There are seven criteria that we think are crucial to assessing proposals for business rate reform:

1. It provides a larger incentive than existing initiatives – The extent to which councils are rewarded for doing beneficial things for their local area
2. It provides councils with a greater degree of financial self-determination – The degree to which councils are able to influence their own financial position through effective economic management
3. It provides a fair incentive for all councils – The extent to which the risk and reward are aligned for every council
4. It retains equity – Whether the principle of redistribution is maintained in some form
5. It is voluntary – The feasibility of making the system voluntary, with a particular focus on ensuring that the benefits are sufficiently attractive for everybody
6. It is implementable – The feasibility of implementation, including political, cultural or legislative barriers
7. It is likely to benefit the national economy – The extent to which the model will demonstrably benefit the country as a whole

The Model

The Buy-Out Model would enable local authorities to buy-out of their net contribution to business rates for specific periods of time. This is a radical option that would preserve the crucial re-distributional element of the current system while also providing greater incentives for local authorities. In addition, it also has notable advantages for the Treasury.

The Buy-Out Model is based on a very simple principle. Any council that believes that, with additional incentives, it can grow its business rates revenue will be able to express an interest to the Treasury. Having received the expression of interest, the Treasury would then negotiate a buy-out tariff with the council.

This tariff would take the form of an agreement between the Treasury and the council for specific sums of money to be paid to or by the council in each of a specified number of years – the 'buy-out tariff' – while the

council is permitted to keep all business rates collected in its area over the same period. Once agreed, the buy-out would last until the following revaluation of business properties (conducted every five years, with the next in 2015), during which time the council would keep all of the business rates revenue it collects.

The model is designed to ensure that every council is able to significantly benefit from any growth in business rates, regardless of whether it is a net beneficiary from, or contributor to, the current system.

Each local authority's buy-out tariff will be designed so that risk and reward are aligned – that is, to ensure that its incentives to pursue sound financial management and promote sustainable economic development are aligned with the risks for not doing so. Equalisation will continue by using the proceeds of buy-outs from net contributor councils to ensure that those councils which are currently net recipients have a negative buy-out tariff – that is, they receive money from the Treasury as part of the buy-out.

The starting point for determining the price of buy-out will be a council's existing net contribution to the NNDR pool. To reflect this, the offer from the Treasury will be positive or negative i.e. during the buy-out period, it will require the council to pay money to the centre every year, or it could guarantee a certain level of top-up grant to be paid from the pool to the council every year. Crucially, however, the buy-out amount will provide certainty for each council: it will know at the start of the buy-out period exactly how much it must submit to or receive from the centre each year, and will get to keep all business rates revenue it collects during the buy-out period.

The buy-out offer will also take account of other key factors to ensure the system is fair while incentivising innovation. It is especially important to ensure that each council bears risk in line with the potential reward it can expect if it creates an environment conducive to economic development. A situation in which councils reaped the full benefits of sounds economic management but saw the Treasury compensate for any falls in business rate revenue could encourage councils to pursue unsustainable models of economic development in an attempt to maximise their financial returns – a situation of moral hazard.

Determining the level of incentive

The level of incentive is based on the following factors:

• *Contribution* – The council's existing net contribution to the national business rate pool.

• *Prospects for Growth* – essential to projecting the total business rates take anticipated in future years, which forms the basis of the buy-out price for these years.

• *Payment* – Up-front buy-outs, which will provide additional money to the Treasury, will be incentivised by means of a percentage adjustment to the buy-out price.

Recommendations

Ensure risk is minimised

- For those few councils with a disproportionately large business rates base, a special risk-sharing arrangement with the Treasury should apply to ensure that the authority will not experience dangerous income volatility.
- The arrangement will mean that these authorities will have a local element and a national element to their business rates base, which will share any above-projection increase or below-projection shortfall.

Provide a solution for two-tier areas

- Councils in two-tier areas put forward a joint 'Federal' proposal for a buyout, with the incentive distribution decided locally.

Recommendations for the negotiation process

- The Buy-Out Model relies on the Treasury and interested councils adopting a reasonable approach to negotiations on future growth projections, but these projections should be based on a few relatively simple and transparent factors.

Volatility

- Councils should ensure that they put measures in place to plan for an ordinary degree of volatility in their business rates revenue.

Economic shocks

- A small levy should be taken from buy-out tariffs to create an Emergency Fund.
- The Fund should be used only in cases of severe and demonstrable economic shocks, and not to compensate for inadequate financial management.
- Access to the Fund should be strictly controlled, either through imposing a stringent set of circumstances in which it can be accessed, or through a process or peer review for any authority wishing to access the Fund.
- Money from the Fund should be treated as a loan to the authority in need, to be paid back when that council's business rates revenue returns to above projection growth (possibly in the next buy-out cycle).

Central list

- Business rate revenue from properties on the central list should continue to be redistributed to authorities whose need exceeds their business rates base.

Provide additional support for the poorest areas

- The Government should establish a fund to support areas with high levels of deprivation to invest in Early Intervention Programmes and Infrastructure Projects.

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